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BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF QWEST
CORPORATION'S FILING OF RENEWED
PRICE REGULATION PLAN.

Docket No. T-01051B-03-0454

**RUCO's RESPONSE TO QWEST'S APPLICATION FOR
REHEARING OF DECISION NO. 66772**

The Residential Utility Consumer Office ("RUCO") files this Response to Qwest Corporation's ("Qwest") Application for Rehearing and An Immediate Stay of Decision No. 66772 ("Application for Rehearing"). As discussed below, RUCO supports rehearing of the Decision as to its requirement that Qwest reduce its access charges, but opposes rehearing on the Decision's requirement that additional Basket 1 price reductions take place on April 1, 2004.

BACKGROUND

In January 1999, Qwest filed an application with the Arizona Corporation Commission ("Commission") for an increase in its Arizona intrastate rates. The procedural schedule on the application was suspended. In October 2000, Qwest and the Commission's Utilities Division ("Staff") filed a Settlement Agreement that included a Price

1 Cap Plan. The Commission held a hearing on the Settlement Agreement in November
2 and December 2000. After holding several public comment sessions and deliberating in
3 Open Meeting for two days, the Commission approved the Settlement Agreement with
4 several modifications on March 22, 2001. The Commission issued its Decision No. 63487
5 in the matter on March 30, 2001.¹

6 The Price Cap Plan originally proposed by Staff and Qwest in their Settlement
7 Agreement divided Qwest's services into three baskets. Basket 1 consisted of
8 Basic/Essential/Non-Competitive Services. Basket 2 consisted of wholesale services.
9 Basket 3 consisted of flexibly priced competitive services. Prices for certain basic Basket
10 1 services were to be capped at their initial levels throughout the initial term of the Plan. In
11 addition, Basket 1 was to be subject to an overall price cap, with possible reductions based
12 on an "inflation minus productivity" indexing mechanism. The Price Cap Plan also
13 provided for changes in rates for intrastate-switched access, a Basket 2 service. The Plan
14 provided for reductions to intrastate switched access rates by \$5 million for each year of
15 the initial term of the Plan, and permitted corresponding increases in Basket 3. The Plan
16 had an initial term of 3 years, at the end of which Qwest could propose renewal of the plan
17 as it exists, or with modifications.

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20 ¹ The Settlement Agreement attached to Decision No. 63487 is not the final version of the Settlement
21 Agreement adopted by the Commission. It is apparently the amended version filed by Staff on December
22 18, 2000, reflecting amendments agreed to by Staff and Qwest to address certain concerns raised by the
23 parties at the hearing. The Commission made further modifications at its Open Meeting as discussed in the
24 text of Decision No. 63487. Those additional modifications are reflected in the version of the Settlement
Agreement attached to Staff and Qwest's April 19, 2001 compliance filing. For ease of reference, RUCO will
refer to the various versions of the Settlement Agreement and Price Cap Plan as the "Proposed" version
(attached to October 20, 2000 Notice of Filing Settlement Agreement in Docket No. T-01051B-99-0105), the
"Revised" version (attached to Staff's December 18, 2000 Notice of Filing Amendments to Agreement in
Docket No. T-01051B-99-0105; also attached to Decision No. 63487), and the "Final" version (attached to
April 19, 2001 compliance filing in Docket No. T-01051B-99-0105).

1 The final Plan approved by the Commission included almost no changes from the
2 originally proposed plan on these matters. After the hearing but before the Commission
3 acted on the plan, Qwest and Staff filed a revised Settlement Agreement reflecting certain
4 modifications that addressed some of the concerns raised by other parties at the hearing.
5 One of those modifications clarified language relating to any "gap period" between the end
6 of the Plan's three-year term and action by the Commission to renew, modify or terminate
7 the Plan.

8 On November 7, 2003, Qwest filed a Motion to Clarify, or in the Alternative, To
9 Terminate Price Cap Plan ("Motion to Clarify"). The Motion to Clarify sought a clarification
10 that the Price Cap Index for Basket 1 services required no further adjustment after March
11 30, 2004, that no further reductions in the level of access charges were required on April 1,
12 2004, and that the Price Cap Plan's other procedures for changing Qwest's rates, including
13 the hard caps imposed on specific Basket 1 services, continued to apply until superceded
14 by a revised plan approved by the Commission or a Commission order setting new rates
15 and charges. Alternatively, the Motion to Clarify requested that the Commission declare
16 that the Plan would terminate on March 30, 2004, returning Qwest to traditional rate-of-
17 return regulation and continuing Qwest's rates at levels existing at termination of the Plan.

18 On November 17, 2003, RUCO filed its Response to the Motion to Clarify. RUCO
19 opposed Qwest's request that the Basket 1 Price Cap Index adjustment cease, but agreed
20 that there should be no further adjustments to access charges. RUCO opposed
21 termination of the Plan as of March 30, 2004.

22 The Commission ruled on Qwest's Motion to Clarify by issuing Decision No. 66772
23 (February 10, 2004). Decision No. 66772 required that the Price Cap Index adjustment for
24

1 Basket 1 services be made on April 1, 2004, and required an addition reduction of
2 switched access charges of \$5 million on April 1, 2004.

3 On February 25, 2004, Qwest filed an Application for Rehearing and an Immediate
4 Stay of Decision No. 66772 ("Application for Rehearing").

5 On March 5, 2004, Qwest filed a Motion to Revise Productivity Factor, requesting
6 that the productivity factor used to calculate the price index adjustment on April 1, 2004 be
7 revised from the current factor of 4.2% to zero. RUCO filed its Response to Qwest's
8 Motion to Revise Productivity Factor on March 15, 2004.

9 Several Commissioners have issued letters supporting discussion on Qwest's
10 Application for Rehearing and Motion to Revise Productivity Factor. Commissioner
11 Mundell's letter asked parties to file responsive pleadings on the Application for Rehearing
12 and Motion to Revise Productivity Factor. Because RUCO has previously filed its
13 Response to the Motion to Revise Productivity Factor, this filing will be limited to
14 responding to the Application for Rehearing.

15
16 **THE PRICE CAP PLAN ONLY CONTEMPLATED THREE ACCESS CHARGE**
17 **REDUCTIONS**

18 Though all the terms of the plan were meant to continue to apply during any gap
19 period, the parties to the Settlement Agreement drafted the Plan to explicitly provide for
20 only three adjustments to access charges, to be implemented upon adoption of the plan (in
21 2001) and at the beginning of the second and third years of the Plan (2002 and 2003).
22 Therefore, no further adjustments to access charges are required under the terms of the
23 Plan.
24

1 The Settlement Agreement provided for a \$5 million reduction to intrastate access
2 charges for the first year of the agreement. Final version of Settlement Agreement, pg. 3.
3 The Agreement also provides that “The Parties further agree that rates for Intrastate
4 Switched Access Service shall be reduced at the start of the second year of the Price Cap
5 Plan to cause an additional \$5 million reduction in revenues from that service and reduced
6 again at the start of the third year of the Price Cap Plan to cause an additional \$5 million
7 reduction in revenues.” *Id.* (emphasis added). The Price Cap Plan itself states
8 “...Intrastate Switched Access Services which are to be reduced \$5 million per year for the
9 duration of the initial term of the Plan, with further reductions in Intrastate Switched Access
10 Service rates taking place during any subsequent term of the Price Cap Plan with the
11 objective of obtaining parity with interstate switched access rates.” Final version of Price
12 Cap Plan, § 3(c). None of these provisions were revised from the Proposed versions of
13 the Settlement Agreement and Price Cap Plan.

14 By referring specifically to an initial reduction and further reductions at the start of
15 the second and third years of the Plan, the Agreement provides no basis for further
16 reductions to access rates during any gap period. Though the terms of the entire Plan
17 continue in effect during the gap period, the Plan makes no provision for additional
18 reductions to access rates after the beginning of the third year of the Plan. Unlike the
19 Plan’s language that the Price Cap Index adjustment in Basket 1 be made “annually”, the
20 Plan provides for only two further adjustments to access rate. Further, the language of
21 Decision 63487 approving the Plan also indicates that the Commission was unwilling to
22 make a commitment to decrease access charges by any specific amount beyond the
23 three-year term. The Commission stated, “While we agree that achieving parity between
24

1 intrastate and interstate switched access rates is a laudable goal, there are many other
2 public policy issues that impact our ability to reach that goal..." Decision No. 63487 at 12.

3 Decision No. 66772 concluded that a further round of access charge reductions
4 should be made beginning April 1, 2004. The Commission expressed concern that
5 Qwest's delay in filing accurate financial statements to permit review of the Price Cap Plan
6 benefited Qwest while burdening its competitors by delaying any further reductions in
7 access charges. While such a result may be unfortunate, the Commission is precluded
8 from remedying the situation by further reducing access rates at this time.

9 Generally the Commission can only adjust a utility's rates based on its finding of the
10 utility's fair value rate base. *Simms v. Round Valley Light & Power Co.*, 80 Ariz. 145, 294
11 P.2d 378 (1956); *US West Comm. v. Ariz. Corp. Comm'n*, 201 Ariz. 242, 34 P.3d 351
12 (2001); *Scates v. Ariz. Corp. Comm'n*, 118 Ariz. 531, 578 P.2d 612 (App. 1978). The
13 access charge reductions adopted in Decision No. 63487 and implemented in 2002 and
14 2003 were based on a fair value finding made in that Decision. However, the mechanism
15 for access charge reductions adopted in the Settlement Agreement and Decision No.
16 63487 did not provide for further reductions. The Commission indicated in Decision No.
17 63487 that, because of competing public policy goals, it was unwilling to commit to a
18 specific plan of further access charge reductions. The pending proceeding to review
19 Qwest's Price Cap Plan, in which the Commission is expected to be making a new finding
20 of fair value, is the appropriate proceeding to adopt any further modifications to access
21 rates that the Commission believes are appropriate in light of the competing public
22 policies.

1 **DECISION NO. 66772 PROPERLY REQUIRED CONTINUATION OF THE PRICE INDEX**
2 **ADJUSTMENT MECHANISM**

3 Decision No. 66772 concludes that a further Price Index adjustment for Basket 1
4 services is appropriate because the Plan required annual Price Index adjustments until
5 such time as the Plan was terminated or modified. Decision No. 66772 at 5-6. Further,
6 the Commission found that the parties to the Settlement Agreement had made statements
7 to the Commission, in the course of promoting the Plan, that the Plan's provisions would
8 continue beyond its initial three-year term until such time as the Commission acted. Id. at
9 7.

10 In its Application for Rehearing, Qwest suggests that the testimony of Ms. Arnold
11 endorsing the Settlement Agreement, which the Commission quoted in Decision 66772,
12 says only that the *price level* established during the initial term of the plan would continue,
13 but does not say that the *reduction mechanism* should continue to be applied. However, at
14 the hearing in which Ms. Arnold gave that testimony, attorneys for both Qwest and Staff
15 suggested that it was the *entire Plan* that would continue during any gap period, and not
16 just the price levels on the last day of the Plan's initial term.

17 During the hearing on the Settlement Agreement, Staff's attorney had the following
18 dialogue with RUCO witness Dr. Johnson on cross-examination:

19 Q. And I know you are not a lawyer, but wouldn't it seem to you,
20 and I'll refer you to page 6 of the settlement agreement, the sentence
21 in the middle of the paragraph: Until the Commission approves the
22 price cap plan, or orders termination of the plan after its term, the plan
23 shall continue in effect.

24 Doesn't that suggest to you that the plan that would remain in
effect refers to the collective terms and conditions or the whole plan,
including hard cap provisions?

A. I think the problem is if you're at the end of three years and the
Commission hasn't taken action to renew the plan, are you still in the

1 term of the plan or are you beyond the term and into some follow-up
2 period until such time as it's renewed?

3 It's just a question of poor draftsmanship. It may well be that
4 you clearly intended that all terms and conditions will continue. But as
5 worded, it's ambiguous, and so there was this concern you might have
6 a gap.

7 And I know you may be sitting there, what is the problem. I'm
8 very familiar, for example, in Indiana, there's opportunity in the Indiana
9 plan. It turned up, proved to be extremely profitable for Ameritech.
10 They're making something like 40 percent on equity as a result of that
11 plan, and there's a tremendous amount of legal activity and litigation
12 going on while the commission was trying to decide whether to renew
13 the plan or what to do about, how to change it.

14 On one hand the company is saying it's a wonderfully
15 successful plan, let's just continue it. On the other hand other parties
16 were saying the productivity factor was wrong, there are other things,
17 you gave them too much flexibility, just look at their profits, far, far
18 exceeding a reasonable level.

19 For literally over a year there has been this gap period. And
20 what is the nature of that gap? Is it a continuation of all the terms or is
21 it something like this, where the hard cap, maybe the hard cap no
22 longer goes into effect?

23 Using that as an example, any ambiguities in a plan like this are
24 of concern because it then gives momentum to whichever side is
trying to argue for one particular interpretation or another, then having
litigation, not necessarily what was the right thing to do, but what was
intended in 2000, 2001 when the plan was adopted.

15 Q. Dr. Johnson, I think the language of the plan was very clear,
16 and referring to the plan finding, in effect, that a reasonable
17 interpretation of that would be that of all the plan's collective terms and
18 conditions.

19 (Transcript, Vol. III, pgs. 443-445, December 1, 2000 hearing in Docket No. T-01051B-99-
20 0105) (emphasis added).

21 Qwest's counsel's cross-examination of Dr. Johnson touched on the same point.

22 Q. Let me ask you the question a little differently. Obviously, this
23 sentence [referring to the same language on page 6 of the Proposed
24 Settlement Agreement that Staff's attorney recited above] suggests
that the plan as a whole continues in effect unless the Commission
continues a renewal or modification. Is that your understanding of the
sentence?

1 A. Yes.

2 (*Id.*, pg. 458) (emphasis added).

3 The Commission properly concluded that, when interpreting the Settlement
4 Agreement/Price Cap Plan, it is instructive to look at the statements of the parties
5 promoting that agreement. While the Commission cited one instance of a statement by a
6 party that suggests that the Plan's terms continue during the gap period, the record before
7 the Commission at the time it adopted the Plan with modifications included other
8 statements by the promoting parties suggesting the same thing.

9 Continuing application of the index mechanism to decrease Basket 1 rates is not
10 inconsistent with termination of the access charge reductions, for two reasons. First, the
11 Settlement Agreement provided different treatment for the two issues. The Settlement
12 Agreement explicitly provided for two further reductions to access charges on the first and
13 second anniversaries of the Plan's implementation—April 1, 2002 and 2003. To the
14 contrary, the Settlement Agreement provided for "annual" reductions pursuant to the index
15 adjustment mechanism. The Plan in its entirety continues to apply during the gap period
16 between the end of its initial three-year term and action by the Commission to modify or
17 terminate it. That Plan, however, made provision for ongoing adjustments to Basket 1
18 prices, but only two adjustments to access rates.

19 Second, further lowering of access rates as a result of the pending review of the
20 price cap plan would not necessarily result in an increase in prices for Basket 1 services.
21 The Commission has already expressed reservations about the impact of shifting access
22 revenues to local exchange customers. See Decision No. 63487 at 12. In addition, the
23 Commission could conclude that, given the pattern of sharply declining unit costs in recent
24 years, intrastate access rates could be reduced without any offsetting increase in monthly

1 fees paid by local customers. See Direct Testimony of RUCO witness Ben Johnson in the
2 generic access docket, T-00000D-00-0672 (consolidated with this docket), filed June 28,
3 2002, at 59.

4 Qwest's Application for Rehearing suggests that, if Basket 1 reductions are
5 continued, the productivity factor used in the Price Cap Index calculation should be reset.
6 Application for Rehearing at 18. Qwest's Motion to Revise Productivity Factor expands on
7 this request. RUCO's response to this request is set forth in its' Response to Qwest's
8 Motion to Revise Productivity Factor, filed on March 15, 2004.

9
10 **IT IS PREMATURE TO CONCLUDE THAT RATES ARE CONFISCATORY**

11 Qwest argues that further decreases to Basket 1 rates would result in rates that are
12 confiscatory. However, the Commission cannot determine whether any particular rates are
13 or are not confiscatory absent a complete analysis of Qwest's revenues and expenses.
14 The Commission's pending proceeding to review the Price Cap Plan will include an
15 analysis of whether Qwest's current rates produce adequate revenues.² The Commission
16 cannot conclude at this point, based only on Qwest's affidavits, that rates after the April 1,
17 2004 decrease would be confiscatory.

18 Qwest's request to modify rates at this stage of the proceeding is contrary to the
19 Commission's long-standing practice of implementing new rates at the conclusion of its
20 rate proceedings rather than at the time an application for rate relief is filed. The
21 Commission's practice of implementing new rates at the end of the proceeding, rather than
22

23 ² Qwest has indicated its' forthcoming filing will be based on 2003 data, with certain proforma
24 adjustments. RUCO anticipates that one such adjustment will reflect the adjustment to Basket 1 services
effective April 1, 2004.

1 at the beginning, is rooted in the constitutional requirement that rates must be based on
2 the fair value of the utility's property. Until such fair value is determined, the Commission
3 has no basis on which it can either conclude that existing rates are insufficient or establish
4 new rates.

5 Qwest's contentions that the Settlement Agreement is void and voidable are both
6 based on the premise that its rates are confiscatory. Because the Commission cannot
7 conclude at this preliminary stage of the proceeding that rates are or will be confiscatory,
8 this is no basis for the Commission to grant rehearing as to the Basket 1 adjustment.

9
10 **CONCLUSION**

11 The Settlement Agreement contemplated only two further adjustments to access
12 charges, in 2002 and 2003. Therefore, the Commission should grant rehearing and modify
13 Decision No. 66772 to remove the requirement for additional access charge decreases on
14 April 1, 2004. However, Decision No. 66772's requirement that Basket 1 prices be
15 decreased on April 1, 2004 pursuant to the price index mechanism is consistent with the
16 Settlement Agreement, and rehearing on this issue should be denied.

17
18 RESPECTFULLY SUBMITTED this 5th day of April, 2004.

19
20 
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23
24

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